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U.S. Office of the Comptroller of...Currency

Duties and liabilities of directors of national banks

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U.S. Comptroller of the Currency.

Duties and liabilites of directers of national banks.

Form 1417
Treasury Department
Office Comptroller of the Currency

DUTIES AND LIABILITIES OF DIRECTORS OF NATIONAL BANKS

FOREWORD

This booklet has been compiled by the office of the Comptroller of the Currency for the use of directors of national banks. It contains provisions of law relating to the election and duties of such directors. These duties consist largely of giving appropriate attention to those aspects of the bank's operations which are supervised by the board of directors, and refraining from acts or operations which are not within the powers granted to the bank or which are specifically prohibited by law.

Part I contains statutory provisions governing the number, election, qualifications, term of office and other matters specifically relating to national bank directors. Part II indicates the powers of national banks, together with a number of the most important limitations on such powers. Part III contains statutes prohibiting specific acts and establishing penalties therefor.

The two provisions of law in Part IV establish the personal liability of national bank directors for damages resulting from violation by them of (1) Title LXII of the United States Revised Statutes, as amended (which contains the National Bank Act and related laws), and (2) the Federal Reserve Act, as amended, which contain most of the laws reprinted in this booklet. In addition there are other provisions of law which specifically impose civil liability for violation thereof.

In addition to their statutory civil liability, directors of a national bank may be liable for losses sustained by the bank as a result of their neglect of duty or failure to perform their duties properly. The nature and extent of such liability for negligence, arising independently of statute, are discussed briefly in Part V. In Part VI appear instructions and suggestions for the guidance of directors in making periodic examinations of the bank, and in Part VII there is a form of by-laws which is in use in many national banks.

After each provision of law quoted in this booklet will be found, in parentheses, a reference to the particular place in the federal statutes at which it appears. If the particular law was contained in the Revised Statutes of the United States, adopted in 1874, reference is made to the section of that compilation in which the particular law appears (see example below). Many of the laws relating to national banks were first adopted after the Revised Statutes were in effect, chiefly in the Federal Reserve Act (1913)* and the Banking Act of 1933, and in such cases reference is made to the section of the particular Act from which the extract is quoted. Most of the laws relating to national banks have been collected in Title 12 of the United States Code, which generally is the most convenient place to examine such laws. For this reason, reference is also made, after each statute, to the section of Title 12 (or other Title) in which it appears. For example: (U.S.R.S. sec. 5200; 12 U.S.C. sec. 84).

In many cases, laws have been considerably amended since their original adoption. As quoted herein, the statutes appear as amended up to July 1, 1945.

It should be borne in mind that *this compilation does not purport to be all-inclusive*, but merely covers a number of questions with which national bank directors are most frequently confronted. Unusual situations, in which the board of directors is uncertain of its powers, duties, and liabilities, should be submitted either to the bank's attorney, the District Chief National Bank Examiner, or the Comptroller of the Currency, Treasury Department, Washington, D. C.

* A number of the laws appearing in this booklet refer to "member banks" of the Federal Reserve System. These laws are applicable to national banks.

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PROVISIONS OF FEDERAL LAW RELATING TO ELECTION, DUTIES, AND LIABILITIES OF NATIONAL BANK DIRECTORS.

[illegible]

I. DIRECTORS: QUALIFICATIONS; ELECTION; PROHIBITION OF CERTAIN CONNECTIONS AND TRANSACTIONS; REMOVAL: ETC.

[Par. 1] Election of Directors; Number; Term; Vacancies.

(a) *Election at Annual Meeting.* The affairs of each association shall be managed by not less than five directors, who shall be elected by the shareholders at a meeting to be held at any time before the association is authorized by the Comptroller of the Currency to commence the business of banking; and afterward at meetings to be held on such day in January of each year as is specified therefor in the articles of association. (*U.S.R.S. sec. 5145; 12 U.S.C. sec. 71.*)

If, from any cause, an election of directors is not made at the time appointed, the association shall not for that cause be dissolved, but an election may be held on any subsequent day, thirty days' notice thereof in all cases having been given in a newspaper published in the city, town, or county in which the association is located; and if no newspaper is published in such city, town, or county, such notice shall be published in a newspaper published nearest thereto. If the articles of association do not fix the day on which the election shall be held, or if no election is held on the day fixed, the day for the election shall be designated by the board of directors in their by-laws, or otherwise; or if the directors fail to fix the day, shareholders representing two-thirds of the shares may do so. (*U.S.R.S. sec. 5149; 12 U.S.C. sec. 75.*)

In all elections of directors, each shareholder shall have the right to vote the number of shares owned by him for as many persons as there are directors to be elected, or to cumulate such shares and give one candidate as many votes as the number of directors multiplied by the number of his shares shall equal, or to distribute them on the same principle among as many candidates as he shall think fit; and in deciding all other questions at meetings of shareholders, each shareholder shall be entitled to one vote on each share of stock held by him.* (*U.S.R.S. sec. 5144; 12 U.S.C. sec. 61.*)

(b) *Number; President to be Director.* The board of directors, board of trustees, or other similar governing body of every national banking association and of every State bank or trust company which is a member of the Federal Reserve System shall consist of not less than five nor more than twenty-five members. (*Banking Act of 1933, sec. 31; 12 U.S.C. sec. 71a.*)

The president of the bank shall be a member of the board. (*U.S.R.S. sec. 5150; 12 U.S.C. sec. 76.*)

(c) *Term of Office.* The directors shall hold office for one year, and until their successors are elected and have qualified. (*U.S.R.S. sec. 5145; 12 U.S.C. sec. 71.*)

(d) *Filling of Vacancies.* Any vacancy in the board shall be filled by the appointment by the remaining directors, and any director so appointed shall hold his place until the next election. (*U.S.R.S. sec. 5148; 12 U.S.C. sec. 74.*)

[Par. 2] Qualifications of Directors.

Every director must during his whole term of service be a citizen of the United States, and at least three-fourths of the directors must have resided in the State, Territory, or District in which the association is located, or within fifty miles of the location of the office of the association, for at least one year immediately preceding their election, and must be residents of such State or within a fifty-mile territory of the location of the association during their continuance in office. Every director must own in his own right shares of the capital stock of the association of which he is a director, the aggregate par value of which shall not be less than $1,000, unless the capital of the bank shall not exceed $25,000, in which case he must own in his own right shares of such capital stock the aggregate par value of which shall not be less than $500. Any director who ceases to be the owner of the required number of shares of the stock, or who becomes in any other manner disqualified, shall thereby vacate his place. (*U.S.R.S. sec. 5146; 12 U.S.C. sec. 72.*)

* Footnote to [Par. 1]: U.S.R.S. sec. 5144 also contains provisions with respect to voting rights of the following: preferred stock; stock held by the bank as trustee; and stock controlled by a holding company affiliate of the bank.

[Par. 3] Oath of Directors.

Each director, when appointed or elected, shall take an oath that he will, so far as the duty devolves on him, diligently and honestly administer the affairs of such association, and will not knowingly violate or willingly permit to be violated, any of the provisions of this title, and that he is the owner in good faith, and in his own right, of the number of shares of stock required by this title, subscribed by him, or standing in his name on the books of the association, and that the same is not hypothecated, or in any way pledged, as security for any loan or debt. The oath shall be taken before a notary public, properly authorized and commissioned by the State in which he resides, or before any other officer having an official seal and authorized by the State to administer oaths, except that the oath shall not be taken before any such notary public or other officer who is an officer of the director's bank. The oath, subscribed by the director making it, and certified by the notary public or other officer before whom it is taken, shall be immediately transmitted to the Comptroller of the Currency and shall be filed and preserved in his office for a period of ten years. (*U.S.R.S. sec. 5147; 12 U.S.C. sec. 73.*)

[Par. 4] Interlocking Bank Directorates.

No private banker or director, officer, or employee of any member bank of the Federal Reserve System or any branch thereof shall be at the same time a director, officer, or employee of any other bank, banking association, savings bank, or trust company organized under the National Bank Act or organized under the laws of any State or of the District of Columbia, or any branch thereof, except that the Board of Governors of the Federal Reserve System may by regulation permit such service as a director, officer, or employee of not more than one other such institution or branch thereof; but the foregoing prohibition shall not apply in the case of any one or more of the following or any branch thereof:

(1) A bank, banking association, savings bank, or trust company, more than 90 per centum of the stock of which is owned directly or indirectly by the United States or by any corporation of which the United States directly or indirectly owns more than 90 per centum of the stock.

(2) A bank, banking association, savings bank, or trust company which has been placed formally in liquidation or which is in the hands of a receiver, conservator, or other official exercising similar functions.

(3) A corporation, principally engaged in international or foreign banking or banking in a dependency or insular possession of the United States which has entered into an agreement with the Board of Governors of the Federal Reserve System pursuant to section 25 of the Federal Reserve Act.

(4) A bank, banking association, savings bank, or trust company, more than 50 per centum of the common stock of which is owned directly or indirectly by persons who own directly or indirectly more than 50 per centum of the common stock of such member bank.

(5) A bank, banking association, savings bank, or trust company not located and having no branch in the same city, town, or village as that in which such member bank or any branch thereof is located, or in any city, town, or village contiguous or adjacent thereto.

(6) A bank, banking association, savings bank, or trust company not engaged in a class or classes of business in which such member bank is engaged.

(7) A mutual savings bank having no capital stock.

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The Board of Governors of the Federal Reserve System is authorized and directed to enforce compliance with this section, and to prescribe such rules and regulations as it deems necessary for that purpose. [See Federal Reserve Regulation L.]

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When any person elected or chosen as a director or officer or selected as an employee of any bank . . . is eligible at the time of his election or selection to act for such bank . . . in such capacity his eligibility to act in such capacity shall not be affected and he shall not become or be deemed amenable to any of the provisions hereof by reason of any change in the affairs of such bank . . . from whatsoever cause, whether specifically excepted by any of the provisions hereof or not, until the expiration of one year from the date of his election or employment. (*Clayton Act sec. 8; 15 U.S.C. sec. 19.*)

[Par. 5] Investment Banking Connections.*

No officer, director, or employee of any corporation or unincorporated association, no partner or employee of any partnership, and no individual, primarily engaged in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, or other similar securities, shall serve the same time as an officer, director, or employee of any member bank except in limited classes of cases in which the Board of Governors of the Federal Reserve System may allow such service by general regulations when in the judgment of the said Board it would not unduly influence the investment policies of such member bank or the advice it gives its customers regarding investments. (*Banking Act of 1933, sec. 32; 12 U.S.C. sec. 78.*)

[Par. 6] Purchases and Sales of Securities, etc., between Bank and Directors.

Any member bank may contract for, or purchase from, any of its directors or from any firm of which any of its directors is a member, any securities or other property, when (and not otherwise) such purchase is made in the regular course of business upon terms not less favorable to the bank than those offered to others, or when such purchase is authorized by a majority of the board of directors not interested in the sale of such securities or property, such authority to be evidenced by the affirmative vote or written assent of such directors: *Provided, however,* That when any director, or firm of which any director is a member, acting for or on behalf of others, sells securities or other property to a member bank, the Federal Reserve Board by regulation may, in any or all cases, require a full disclosure to be made, on forms to be prescribed by it, of all commissions or other considerations received, and whenever such director or firm, acting in his or its own behalf, sells securities or other property to the bank the Federal Reserve Board, by regulation, may require a full disclosure of all profit realized from such sale.

Any member bank may sell securities or other property to any of its directors, or to a firm of which any of its directors is a member, in the regular course of business on terms not more favorable to such director or firm than those offered to others, or when such sale is authorized by a majority of the board of directors of a member bank to be evidenced by their affirmative vote or written assent: *Provided, however,* That nothing in this subsection contained shall be construed as authorizing member banks to purchase or sell securities or other property which such banks are not otherwise authorized by law to purchase or sell. (*Fed. Res. Act, sec. 22; 12 U.S.C. sec. 375.*)

[Par. 7] Interest Rate on Directors' Deposits.

No member bank shall pay to any director, officer, attorney, or employee a greater rate of interest on the deposits of such director, officer, attorney, or employee than that paid to other depositors on similar deposits with such member bank. (*Fed. Res. Act, sec. 22; 12 U.S.C. sec. 376.*)

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* Footnote to [Par. 5]: Section 20 of Banking Act of 1933 (12 U.S.C. sec. 377) prohibits member banks themselves from being affiliated with any investment banking organization. The term "affiliate" is defined in Banking Act of 1933, sec. 2; 12 U.S.C. sec. 221a, which is quoted in the footnote to [Par. 18].

[Par. 8] Prohibition of Loans of Trust Funds to Directors.

It shall be unlawful for any national banking association to lend any officer, director, or employee any funds held in trust under the powers conferred by this section. Any officer, director, or employee making such loan, or to whom such loan is made, may be fined not more than $5,000, or imprisoned not more than five years, or may be both fined and imprisoned, in the discretion of the court. (*Fed. Res. Act, sec. 11(k); 12 U.S.C. sec. 248(k).*)

[Par. 9] Prohibition against Director Receiving Fee for Making Loans, etc.

Except as herein provided, any officer, director, employee, or attorney of a member bank who stipulates for or receives or consents or agrees to receive any fee, commission, gift, or thing of value from any person, firm, or corporation, for procuring or endeavoring to procure for such person, firm, or corporation, or for any other person, firm, or corporation, any loan from or the purchase or discount of any paper, note, draft, check, or bill of exchange by such member bank shall be deemed guilty of a misdemeanor and shall be imprisoned not more than one year or fined not more than $5,000, or both. (*Fed. Res. Act, sec. 22; 12 U.S.C. sec. 595.*)

[Par. 10] Removal of Directors.

Whenever, in the opinion of the Comptroller of the Currency, any director or officer of a national bank, or of a bank or trust company doing business in the District of Columbia, or whenever, in the opinion of a Federal Reserve agent, any director or officer of a State member bank in his district shall have continued to violate any law relating to such bank or trust company or shall have continued unsafe or unsound practices in conducting the business of such bank or trust company, after having been warned by the Comptroller of the Currency or the Federal Reserve agent, as the case may be, to discontinue such violations of law or such unsafe or unsound practices, the Comptroller of the Currency or the Federal Reserve agent, as the case may be, may certify the facts to the Federal Reserve Board. In any such case the Federal Reserve Board may cause notice to be served upon such director or officer to appear before such Board to show cause why he should not be removed from office. A copy of such order shall be sent to each director of the bank affected, by registered mail. If after granting the accused director or officer a reasonable opportunity to be heard, the Federal Reserve Board finds that he has continued to violate any law relating to such bank or trust company or has continued unsafe or unsound practices in conducting the business of such bank or trust company after having been warned by the Comptroller of the Currency or the Federal Reserve agent to discontinue such violation of law or such unsafe or unsound practices, the Federal Reserve Board, in its discretion, may order that such director or officer be removed from office. A copy of such order shall be served upon such director or officer. A copy of such order shall also be served upon the bank of which he is a director or officer, whereupon such director or officer shall cease to be a director or officer of such bank: *Provided*, That such order and the findings of fact upon which it is based shall not be made public or disclosed to anyone except the director or officer involved and the directors of the bank involved, otherwise than in connection with proceedings for a violation of this section. Any such director or officer removed from office as herein provided who thereafter participates in any manner in the management of such bank shall be fined not more than $5,000, or imprisoned for not more than five years, or both, in the discretion of the court. (*Banking Act of 1933, sec. 30; 12 U.S.C. sec. 77.*)

II. POWERS OF NATIONAL BANKS, AND LIMITATIONS THEREON

[Par. 11] General Powers of National Banks.

A national banking association * * * shall have power—

Third. To make contracts.

Fourth. To sue and be sued, complain and defend, in any court of law and equity, as fully as natural persons.

Fifth. To elect or appoint directors, and by its board of directors to appoint a president, vice president, cashier, and other officers, define their duties, require bonds of them, and fix the penalty thereof, dismiss such officers or any of them at pleasure, and appoint others to fill their places.

Sixth. To prescribe, by its board of directors, by-laws not inconsistent with law, regulating the manner in which its stock shall be transferred, its directors elected or appointed, its officers appointed, its property transferred, its general business conducted, and the privileges granted to it by law exercised and enjoyed.

Seventh. To exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this title.

Eighth. To contribute to community funds, or to charitable, philanthropic, or benevolent instrumentalities conducive to public welfare, such sums as its board of directors may deem expedient and in the interests of the association, if it is located in a State the laws of which do not expressly prohibit State banking institutions from contributing to such funds or instrumentalities. (*U.S.R.S. sec. 5136; 12 U.S.C. sec. 24.*)

[Par. 12] Limitation on Indebtedness Incurred by Bank.

No national banking association shall at any time be indebted, or in any way liable, to an amount exceeding the amount of its capital stock at such time actually paid in and remaining undiminished by losses or otherwise, except on account of demands of the following nature:

First. Notes of circulation.

Second. Moneys deposited with or collected by the association.

Third. Bills of exchange or drafts drawn against money actually on deposit to the credit of the association, or due thereto.

Fourth. Liabilities to the stockholders of the association for dividends and reserve profits.

Fifth. Liabilities incurred under the provisions of the Federal Reserve Act [12 U.S.C., Ch. 3].

Sixth. Liabilities incurred under the provisions of the Reconstruction Finance Corporation Act [15 U.S.C., Ch. 14].

Seventh. Liabilities created by the endorsement of accepted bills of exchange payable abroad actually owned by the endorsing bank and discounted at home or abroad.

Eighth. Liabilities incurred under the provisions of section 202 of Title II of the Federal Farm Loan Act, approved July 17, 1916, as amended by the Agricultural Credits Act of 1923 [12 U.S.C. sec. 1171].

Ninth. Liabilities incurred on account of loans made with the express approval of the Comptroller of the Currency under paragraph (9) of section 5200 of the Revised Statutes, as amended [12 U.S.C. sec. 84; see Par. 13].

Tenth. Liabilities incurred under the provisions of section 13b of the Federal Reserve Act [12 U.S.C. sec. 352a]. (*U.S.R.S. sec. 5202; 12 U.S.C. sec. 82.*)

[Par. 13] Limitation on Liability of Any One Person to Bank.

The total obligations to any national banking association of any person, copartnership, association, or corporation shall at no time exceed 10 per centum of the amount of the capital stock of such association actually paid in and unimpaired and 10 per centum of its unimpaired surplus fund.

The term "obligations" shall mean the direct liability of the maker or acceptor of paper discounted with or sold to such association and the liability of the endorser, drawer, or guarantor who obtains a loan from or discounts paper with or sells paper under his guaranty to such association and shall include in the case of obligations of a copartnership or association the obligations of the several members thereof and shall include in the case of obligations of a corporation all obligations of all subsidiaries thereof in which such corporation owns or controls a majority interest.

Such limitation of 10 per centum shall be subject to the following exceptions:

(1) Obligations in the form of drafts or bills of exchange drawn in good faith against actually existing values shall not be subject under this section to any limitation based upon such capital and surplus.

(2) Obligations arising out of the discount of commercial or business paper actually owned by the person, copartnership, association, or corporation negotiating the same shall not be subject under this section to any limitation based upon such capital and surplus.

(3) Obligations drawn in good faith against actually existing values and secured by goods or commodities in process of shipment shall not be subject under this section to any limitation based upon such capital and surplus.

(4) Obligations as endorser or guarantor of notes, other than commercial or business paper excepted under (2) hereof, having a maturity of not more than six months, and owned by the person, corporation, association, or copartnership endorsing and negotiating the same, shall be subject under this section to a limitation of 15 per centum of such capital and surplus in addition to such 10 per centum of such capital and surplus.

(5) Obligations in the form of banker's acceptances of other banks of the kind described in section 13 of the Federal Reserve Act shall not be subject under this section to any limitation based upon such capital and surplus.

(6) Obligations of any person, copartnership, association, or corporation, in the form of notes or drafts secured by shipping documents, warehouse receipts, or other such documents transferring or securing title covering readily marketable nonperishable staples when such property is fully covered by insurance, if it is customary to insure such staples, shall be subject under this section to a limitation of 15 per centum of such capital and surplus in addition to such 10 per centum of such capital and surplus when the market value of such staples securing such obligation is not at any time less than 115 per centum of the face amount of such obligation, and to an additional increase of limitation of 5 per centum of such capital and surplus in addition to such 25 per centum of such capital and surplus when the market value of such staples securing such additional obligation is not at any time less than 120 per centum of the face amount of such additional obligation, and to a further additional increase of limitation of 5 per centum of such capital and surplus in addition to such 30 per centum of such capital and surplus when the market value of such staples securing such additional obligation is not at any time less than 125 per centum of the face amount of such additional obligation, and to a further additional increase of limitation of 5 per centum of such capital and surplus in addition to such 35 per centum of such capital and surplus when the market value of such staples securing such additional obligation is not at any time less than 130 per centum of the face amount of such additional obligation, and to a further additional increase of limitation of 5 per centum of such capital and surplus in addition to such 40 per centum of such capital and surplus when the market value of such staples securing such additional obligation is not at any time less than 135 per centum of the face amount of such additional obligation, and to a further addi-

tional increase of limitation of 5 per centum of such capital and surplus in addition to such 45 per centum of such capital and surplus when the market value of such staples securing such additional obligation is not at any time less than 140 per centum of the face amount of such additional obligation, but this exception shall not apply to obligations of any one person, copartnership, association or corporation arising from the same transactions and/or secured upon the identical staples for more than ten months.

(7) Obligations of any person, copartnership, association, or corporation in the form of notes or drafts secured by shipping documents or instruments transferring or securing title covering livestock or giving a lien on livestock when the market value of the livestock securing the obligation is not at any time less than 115 per centum of the face amount of the notes covered by such documents shall be subject under this section to a limitation of 15 per centum of such capital and surplus in addition to such 10 per centum of such capital and surplus.

(8) Obligations of any person, copartnership, association, or corporation in the form of notes secured by not less than a like amount of bonds or notes of the United States issued since April 24, 1917, or certificates of indebtedness of the United States, Treasury bills of the United States, or obligations fully guaranteed both as to principal and interest by the United States, shall (except to the extent permitted by rules and regulations prescribed by the Comptroller of the Currency, with the approval of the Secretary of the Treasury) be subject under this section to a limitation of 15 per centum of such capital and surplus in addition to such 10 per centum of such capital and surplus.

(9) Obligations representing loans to any national banking association or to any banking institution organized under the laws of any State, or to any receiver, conservator, or superintendent of banks, or to any other agent, in charge of the business and property of any such association or banking institution, when such loans are approved by the Comptroller of the Currency, shall not be subject under this section to any limitation based upon such capital and surplus.

(10) Obligations shall not be subject under this section to any limitation based upon such capital and surplus to the extent that such obligations are secured or covered by guaranties, or by commitments or agreements to take over or to purchase, made by any Federal Reserve bank or by the United States or any department, bureau, board, commission, or establishment of the United States, including any corporation wholly owned directly or indirectly by the United States; *Provided*, That such guaranties, agreements, or commitments are unconditional and must be performed by payment of cash or its equivalent within sixty days after demand. The Comptroller of the Currency is hereby authorized to define the terms herein used if and when he may deem it necessary. (U.S.R.S. sec. 5200; 12 U.S.C. 84.)

[Par. 14] Limitation on Deposits with Non-Member Banks.

No member bank shall keep on deposit with any State bank or trust company which is not a member bank a sum in excess of 10 per centum of its own paid-up capital and surplus. (*Fed. Res. Act, sec. 19; 12 U.S.C. 463.*)

[Par. 15] Limitation on Bank's Ownership of, and Dealing in, Securities.

The business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock: *Provided*, That the association may purchase for its own account investment securities under such limitations and restriction as the Comptroller of the Currency may by regulation prescribe. In no event shall the total amount of the investment securities of any one obligor or maker, held by the association for its own account, exceed at any time 10 per centum of its capital stock actually paid in and unimpaired and 10 per centum of its unimpaired surplus fund, except that this limitation shall not require any association to dispose of any securities lawfully held by it on August 23, 1935. As used in this section the term "investment securities" shall mean marketable obligations evidencing indebtedness of any person, copartnership, association, or corporation in the form of bonds, notes, and/or debentures commonly known as investment securities under such further definition of the term "investment securities" as may by regulation be prescribed by the Comptroller of the Currency. Except as hereinafter provided or otherwise permitted by law, nothing herein contained shall authorize the purchase by the association for its own account of any shares of stock of any corporation. The limitations and restrictions herein contained as to dealing in, underwriting, and purchasing for its own account, investment securities shall not apply to obligations of the United States, or general obligations of any State or of any political subdivision thereof, or obligations issued under authority of the Federal Farm Loan Act, as amended, or issued by the Federal home loan banks or the Home Owners' Loan Corporation, or obligations which are insured by the Federal Housing Administrator pursuant to section 207 of the National Housing Act, if the debentures to be issued in payment of such insured obligations are guaranteed as to principal and interest by the United States, or obligations of national mortgage associations: *Provided*, That in carrying on the business commonly known as the safe-deposit business the association shall not invest in the capital stock of a corporation organized under the law of any State to conduct a safe-deposit business in an amount in excess of 15 per centum of the capital stock of the association actually paid in and unimpaired and 15 per centum of its unimpaired surplus. (*U.S.R.S. sec. 5136; 12 U.S.C. sec. 24.*)

[Par. 16] Loans for Purchase or Carrying of Listed Securities.

[Under Section 7 of the Securities Exchange Act of 1934 (15 U.S.C. sec. 78g), the Board of Governors of the Federal Reserve System is empowered to issue regulations governing the amount of credit that may be extended by banks to finance the purchase or carrying of any equity security registered on a national securities exchange. The term "equity security" includes stocks, voting trust certificates, and similar securities.

Pursuant to this authority, the Board of Governors of the Federal Reserve System has issued Regulation U, which governs the amount which banks may lend upon stock collateral for the purchase or carrying of equity securities, and provides certain exceptions to the general requirements. In an explanatory foreword to the regulation, the Board of Governors points out that

(a) The regulation does not restrict the right of a bank to extend credit, whether on securities or otherwise, for any commercial, agricultural, or industrial purpose, or for any other purpose except the purchasing or carrying of stocks registered on a national securities exchange.

(b) The regulation does not prevent a bank from taking for any loan collateral in addition to that required by the regulation, nor does it require a bank to reduce any loan, to obtain additional collateral for any outstanding loan, or to call any outstanding loan because of insufficient collateral.

In extending loans for the purposes specified above, a national bank must comply with the limitations and conditions prescribed in Regulation U. Any inquiry relating to Regulation U should be addressed to the Federal Reserve bank of the district in which the bank is located.]

[Par. 17] Loans Secured by Real Estate.

Any national banking association may make real estate loans secured by first liens upon improved real estate, including improved farm land and improved business and residential properties. A loan secured by real estate within the meaning of this section shall be in the form of an obligation or obligations secured by mortgage, trust deed, or other such instrument upon real estate, and any national banking association may purchase any obligation so secured when the entire amount of such obligation is sold to the association. The amount of any such loan hereafter made shall not exceed 50 per centum of the appraised value of the real estate offered as security and no such loan shall be made for a longer term than five years; except that (1) any such loan may be made in an amount not to exceed 60 per centum of the appraised value of the real estate offered as security and for a term not longer than ten years if the loan is secured by an amortized mortgage, deed of trust, or other such instrument under the terms of which the installment payments are sufficient to amortize 40 per centum or more of the principal of the loan within a period of not more than ten years, and (2) the foregoing limitations and restrictions shall not prevent the renewal or extension of loans heretofore made and shall not apply to real estate loans which are insured under the provisions of Titles II and VI of the National Housing Act. No such association shall make such loans in an aggregate sum in excess of the amount of the capital stock of such association paid in and unimpaired plus the amount of its unimpaired surplus fund, or in excess of 60 per centum of the amount of its time and savings deposits, whichever is the greater. Any such association may continue hereafter as heretofore to receive time and savings deposits and to pay interest on the same, but the rate of interest which such association may pay upon such time deposits or upon savings or other deposits shall not exceed the maximum rate authorized by law to be paid upon such deposits by State banks or trust companies organized under the laws of the State in which such association is located.

Loans made to finance the construction of residential or farm buildings and having maturities of not to exceed six months, whether or not secured by a mortgage or similar lien on the real estate upon which the residential or farm building is being constructed, shall not be considered as loans secured by real estate within the meaning of this section but shall be classed as ordinary commercial loans: *Provided*, That no national banking association shall invest in, or be liable on, any such loans in an aggregate amount in excess of 50 per centum of its actually paid-in and unimpaired capital. Notes representing such loans shall be eligible for discount as commercial paper within the terms of the second paragraph of section 13 of the Federal Reserve Act, as amended, if accompanied by a valid and binding agreement to advance the full amount of the loan upon the completion of the building entered into by an individual, partnership, association, or corporation acceptable to the discounting bank.

Loans made to established industrial or commercial businesses (a) which are in whole or in part discounted or purchased or loaned against as security by a Federal Reserve bank under the provisions of section 13b of this Act, (b) for any part of which a commitment shall have been made by a Federal Reserve bank under the provisions of said section, (c) in the making of which a Federal Reserve bank participates under the provisions of said section, or (d) in which the Reconstruction Finance Corporation cooperates or purchases a participation under the provisions of section 5d of the Reconstruction Finance Corporation Act, shall not be subject to the restrictions or limitations of this section upon loans secured by real estate. (*Fed. Res. Act, sec. 24; 12 U.S.C. sec. 371.*)

[Par. 18] Loans to Affiliates; Purchase of Securities of Affiliates; Loans Collateralized by Securities of Affiliates.*

No member bank shall (1) make any loan or any extension of credit to, or purchase securities under repurchase agreement from, any of its affiliates,* or (2) invest any of its funds in the capital stock, bonds, debentures, or other such obligations of any such affiliate, or (3) accept the capital stock, bonds, debentures, or other such obligations of any such affiliate as collateral security for advances made to any person, partnership, association, or corporation, if, in the case of any such affiliate, the aggregate amount of such loans, extensions of credit, repurchase agreements, investments, and advances against such collateral security will exceed 10 per centum of the capital stock and surplus of such member bank, or if, in the case of all such affiliates, the aggregate amount of such loans, extensions of credits, repurchase agreements, investments, and advances against such collateral security will exceed 20 per centum of the capital stock and surplus of such member bank.

Within the foregoing limitations, each loan or extension of credit of any kind or character to an affiliate shall be secured by collateral in the form of stocks, bonds, debentures, or other such obligations having a market value at the time of making the loan or extension of credit of at least 20 per centum more than the amount of the loan or extension of credit, or of at least 10 per centum more than the amount of the loan or extension of credit if it is secured by obligations of any State, or of any political subdivision or agency thereof: *Provided*, That the provisions of this paragraph shall not apply to loans or extensions of credit secured by obligations of the United States Government, the Federal intermediate credit banks, the Federal land banks, the Federal home loan banks, or the Home Owners' Loan Corporation, or by such notes, drafts, bills of exchange, or bankers' acceptances as are eligible for rediscount or for purchase by Federal reserve banks. A loan or extension of credit to a director, officer, clerk, or other employee or any representative of any such affiliate shall be deemed a loan to the affiliate to the extent that the proceeds of such loan are used for the benefit of, or transferred to, the affiliate.

For the purpose of this section, the term "affiliate" shall include holding-company affiliates* as well as other affiliates, and the provisions of this section shall not apply to any affiliate (1) engaged on June 16, 1934, in holding the bank premises of the member bank with which it is affiliated or in maintaining and operating properties acquired for banking purposes prior to such date; (2) engaged solely in conducting a safe-deposit business or the business of an agricultural credit corporation or livestock loan company; (3) in the capital stock of which a national banking association is authorized to invest pursuant to section 25 of this Act, as amended, or a subsidiary of such affiliate, all the

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* Footnote to [Par. 18]. The terms "affiliate" and "holding company affiliate" are defined in Banking Act of 1933, sec. 2; 12 U.S.C sec. 221a, as follows:

"(b) Except where otherwise specifically provided, the term 'affiliate' shall include any corporation, business trust, association, or other similar organization—

"(1) Of which a member bank, directly or indirectly, owns or controls either a majority of the voting shares or more than 50 per centum of the number of shares voted for the election of its directors, trustees, or other persons exercising similar functions at the preceding election, or controls in any manner the election of a majority of its directors, trustees, or other persons exercising similar functions; or

"(2) Of which control is held, directly or indirectly, through stock ownership or in any other manner, by the shareholders of a member bank who own or control either a majority of the shares of such bank or more than 50 per centum of the number of shares voted for the election of directors of such bank at the preceding election, or by trustees for the benefit of the shareholders of any such bank; or

"(3) Of which a majority of its directors, trustees, or other persons exercising similar functions are directors of any one member bank.

"(c) The term 'holding company affiliate' shall include any corporation, business trust, association, or other similar organization—

"(1) Which owns or controls, directly or indirectly, either a majority of the shares of capital stock of a member bank or more than 50 per centum of the number of shares voted for the election of directors of any one bank at the preceding election, or controls in any manner the election of a majority of the directors of any one bank; or

"(2) For the benefit of whose shareholders or members all or substantially all the capital stock of a member bank is held by trustees."

Banking Act of 1933, sec. 20; 12 U.S.C. sec. 377, prohibits member banks from being affiliated "with any corporation, association, business trust, or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities."

stock of which (except qualifying shares of directors in an amount not to exceed 10 per centum) is owned by such affiliate; (4) organized under section 25 (a) of this Act, as amended, or a subsidiary of such affiliate, all the stock of which (except qualifying shares of directors in an amount not to exceed 10 per centum) is owned by such affiliate; (5) engaged solely in holding obligations of the United States or obligations fully guaranteed by the United States as to principal and interest, the Federal intermediate credit banks, the Federal land banks, the Federal Home Loan Banks, or the Home Owners' Loan Corporation; (6) where the affiliate relationship has arisen out of a bona fide debt contracted prior to the date of the creation of such relationship; or (7) where the affiliate relationship exists by reason of the ownership or control of any voting shares thereof by a member bank as executor, administrator, trustee, receiver, agent, depositary, or in any other fiduciary capacity, except where such shares are held for the benefit of all or a majority of the stockholders of such member bank; but as to any such affiliate, member banks shall continue to be subject to other provisions of law applicable to loans by such banks and investments by such banks in stocks, bonds, debentures, or other such obligations. The provisions of this section shall likewise not apply to indebtedness of any affiliate for unpaid balances due a bank on assets purchased from such bank or to loans secured by, or extensions of credit against, obligations of the United States or obligations fully guaranteed by the United States as to principal and interest. (*Fed. Res. Act sec. 23A; 12 U.S.C. sec. 371c.*)

[Par. 19] Investment in Bank Premises.

Hereafter no national bank, without the approval of the Comptroller of the Currency, and no State member bank, without the approval of the Federal Reserve Board, shall (1) invest in bank premises, or in the stock, bonds, debentures, or other such obligations of any corporation holding the premises of such bank or (2) make loans to or upon the security of the stock of any such corporation, if the aggregate of all such investments and loans will exceed the amount of the capital stock of such bank. (*Fed. Res. Act, sec. 24A; 12 U.S.C. sec. 371d.*)

[Par. 20] Payment of Interest on Demand, Time, and Savings Deposits, etc.

No member bank shall, directly or indirectly, by any device whatsoever, pay any interest on any deposit which is payable on demand. . . .

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The Board of Governors of the Federal Reserve System shall from time to time limit by regulation the rate of interest which may be paid by member banks on time and savings deposits, and shall prescribe different rates for such payment on time and savings deposits having different maturities, or subject to different conditions respecting withdrawal or repayment, or subject to different conditions by reason of different locations, or according to the varying discount rates of member banks in the several Federal Reserve districts. [See Federal Reserve Regulation Q.] No member banks shall pay any time deposit before its maturity except upon such conditions and in accordance with such rules and regulations as may be prescribed by the said Board, or waive any requirement of notice before payment of any savings deposit except as to all savings deposits having the same requirement. . . . (*Fed. Res. Act, sec. 19; 12 U.S.C. secs. 371a, 371b.*)

[Par. 21] Loans to Executive Officers.

No executive officer of any member bank shall borrow from or otherwise become indebted to any member bank of which he is an executive officer, and no member bank shall make any loan or extend credit in any other manner to any of its own executive officers: *Provided,* That loans made to any such officer prior to June 16, 1933, may be renewed or extended for periods expiring not more than five years from June 16, 1939 where the board of directors of the member bank shall have satisfied themselves that such extension or renewal is in the best interest of the bank and that the officer indebted has made reasonable effort to reduce his obligation, these findings to be evidenced by resolution of the board of directors spread upon the minute book of the bank: *Provided further,* That with the prior approval of a majority of the entire board of directors, any member bank may extend credit to any executive officer thereof, and such officer may become indebted thereto, in an amount not exceeding $2,500. If any executive officer of any member bank borrow from or if he be or become indebted to any bank other than a member bank of which he is an executive officer, he shall make a written report to the board of directors of the member bank of which he is an executive officer, stating the date and amount of such loan or indebtedness, the security therefor, and the purpose for which the proceeds have been or are to be used. Borrowing by, or loaning to, a partnership in which one or more executive officers of a member bank are partners having either individually or together a majority interest in said partnership, shall be considered within the prohibition of this subsection. Nothing contained in this subsection shall prohibit any executive officer of a member bank from endorsing or guaranteeing for the protection of such bank any loan or other asset which shall have been previously acquired by such bank in good faith or from incurring any indebtedness to such bank for the purpose of protecting such bank against loss or giving financial assistance to it. The Board of Governors of the Federal Reserve System is authorized to define the term "executive officer," to determine what shall be deemed to be a borrowing, indebtedness, loan, or extension of credit, for the purposes of this subsection, and to prescribe such rules and regulations as it may deem necessary to effectuate the provisions of this subsection in accordance with its purposes and to prevent evasions of such provisions. [See Federal Reserve Regulation O.] Any executive officer of a member bank accepting a loan or extension of credit which is in violation of the provisions of this subsection shall be subject to removal from office in the manner prescribed in section 30 of the Banking Act of 1933 [See Par.10]: *Provided,* That for each day that a loan or extension of credit made in violation of this subsection exists, it shall be deemed to be a continuation of such violation within the meaning of said section 30. (*Fed. Res. Act, sec. 22(g); 12 U.S.C. sec. 375a.*)

[Par. 22] Discounting with Federal Reserve Bank on Behalf of Non-Member Bank.

No member bank shall act as the medium or agent of a non-member bank in applying for or receiving discounts from a Federal Reserve Bank under the provisions of this act, except by permission of the Federal Reserve Board. (*Fed. Res. Act, sec. 19; 12 U.S.C. sec. 374.*)

[Par. 23] Trust Departments of National Banks.

The Board of Governors of the Federal Reserve System shall be authorized and empowered: . . .

(k) To grant by special permit to national banks applying therefor, when not in contravention of State or local law, the right to act as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, committee of estates of lunatics, or in any other fiduciary capacity in which State banks, trust companies, or other corporations which come into competition with national banks are permitted to act under the laws of the State in which the national bank is located. (*Fed. Res. Act, sec. 11(k); 12 U.S.C. sec. 248(k).**

* Footnote to [Par. 23]: The remainder of section 11(k), and Federal Reserve Regulation F, adopted thereunder, contain detailed provisions governing the trustee and other fiduciary activities of national banks.

[Par. 24] Publication by Bank of Reports of Condition.

Every association shall make to the Comptroller of the Currency not less than three reports during each year, according to the form which may be prescribed by him, verified by the oath or affirmation of the president, or of the cashier, or of a vice president, or of an assistant cashier of the association designated by its board of directors to verify such reports in the absence of the president and cashier, taken before a notary public properly authorized and commissioned by the State in which such notary resides and the association is located, or any other officer having an official seal, authorized in such State to administer oaths, and attested by the signature of at least three of the directors. Each such report shall exhibit, in detail and under appropriate heads, the resources and liabilities of the association at the close of business on any past day within five days after the receipt of a request or requisition therefor from him; and the statement of resources and liabilities, together with acknowledgment and attestation in the same form in which it is made to the Comptroller, shall be published in a newspaper published in the place where such association is established, or if there is no newspaper in the place, then in the one published nearest thereto in the same county, at the expense of the association; and such proof of publication shall be furnished as may be required by the Comptroller. The Comptroller shall also have power to call for special reports from any particular association whenever in his judgment the same are necessary in order to obtain a full and complete knowledge of its condition.† (*U.S.R.S. sec. 5211; 12 U.S.C. sec. 161.*)

[Par. 25] Examination of National Banks and Affiliates.

The Comptroller of the Currency, with the approval of the Secretary of the Treasury, shall appoint examiners who shall examine every member bank at least twice in each calendar year and oftener if considered necessary * * *. The examiner making the examination of any national bank, or of any other member bank, shall have power to make a thorough examination of all the affairs of the bank and in doing so he shall have power to administer oaths* and to examine any of the officers and agents thereof under oath* and shall make a full and detailed report of the condition of said bank to the Comptroller of the Currency: *Provided*, That in making the examination of any national bank the examiners shall include such an examination of the affairs of all its affiliates other than member banks as shall be necessary to disclose fully the relations between such bank and such affiliates and the effect of such relations upon the affairs of such bank; and in the event of the refusal to give any information required in the course of the examination of any such affiliate, or in the event of the refusal to permit such examination, all the rights, privileges, and franchises of the bank shall be subject to forfeiture in accordance with section 2 of the Federal Reserve Act, as amended. The Comptroller of the Currency shall have power, and he is hereby authorized, to publish the report of his examination of any national banking association or affiliate which shall not within one hundred and twenty days after notification of the recommendations or suggestions of the Comptroller, based on said examination, have complied with the same to his satisfaction. Ninety days' notice prior to such publicity shall be given to the bank or affiliate. (*U.S.R.S. sec. 5240; 12 U.S.C. sec. 481.*)

† Footnote to [Par. 24]: U.S.R.S. sec. 5211 also contains requirements with respect to regular reports covering affiliates of national banks. The term "affiliate" is defined in the footnote to [Par. 18].

* Footnote to [Par. 25]: Whoever, having taken an oath before a competent tribunal, officer, or person, in any case in which a law of the United States authorizes an oath to be administered, that he will testify, declare, depose, or certify truly, or that any written testimony, declaration, deposition, or certificate by him subscribed, is true, shall willfully and contrary to such oath state or subscribe any material matter which he does not believe to be true, is guilty of perjury, and shall be fined not more than $2,000 and imprisoned not more than five years. (*U.S.R.S. sec. 5392; 18 U.S.C. sec. 231.*)

[Par. 26] Dividends on Capital Stock; Withdrawal of Capital.

The directors of any association may, semiannually, declare a dividend of so much of the net profits of the association as they shall judge expedient; but each association shall, before the declaration of a dividend on its shares of common stock, carrying not less than one-tenth part of its net profits of the preceding half year to its surplus fund until the same shall equal the amount of its common capital: *Provided*, That for the purposes of this section, any amounts paid into a fund for the retirement of any preferred stock of any such association out of its net earnings for such half-year period shall be deemed to be an addition to its surplus fund if, upon the retirement of such preferred stock, the amount so paid into such retirement fund for such period may then properly be carried to surplus. In any such case the association shall be obligated to transfer to surplus the amounts so paid into such retirement fund for such period on account of the preferred stock as such stock is retired. (*U.S.R.S. sec. 5199; 12 U.S.C. sec. 60.*)

No association, or any member thereof, shall during the time it shall continue its banking operations, withdraw, or permit to be withdrawn, either in the form of dividends or otherwise, any portion of its capital. If losses have at any time been sustained by any such association, equal to or exceeding its undivided profits then on hand, no dividend shall be made; and no dividend shall ever be made by any association, while it continues its banking operations, to an amount greater than its net profits then on hand, deducting therefrom its losses and bad debts. All debts due to any association, on which interest is past due and unpaid for a period of six months, unless the same are well secured, and in process of collection, shall be considered bad debts within the meaning of this section. But nothing in this section shall prevent the reduction of the capital stock of the association under section 5143 [of U.S.R.S.; 12 U.S.C. sec. 59]. (*U.S.R.S. sec. 5204; 12 U.S.C. sec. 56.*)

III. SOME CRIMINAL LAWS APPLICABLE TO NATIONAL BANK DIRECTORS

[Par. 27] False Entries, False Reports, etc.

Any officer, director, agent, or employee * * * of any national banking association * * * who makes any false entry in any book, report, or statement of * * * such national banking association * * *, with intent in any case * * * to deceive * * * the Comptroller of the Currency, * * * or any agent or examiner appointed to examine the affairs of * * * such national banking association * * *, and every person who, with like intent, aids or abets any officer, director, agent, employee, or receiver in any violation of this section shall be deemed guilty of a misdemeanor, and upon conviction thereof in any district court of the United States shall be fined not more than $5,000 or shall be imprisoned for not more than 5 years, or both, in the discretion of the court. (*U.S.R.S. sec. 5209; 12 U.S.C. sec. 592.*)

[Par. 28] False Certification of Checks.

It shall be unlawful for any officer, director, agent, or employee of * * * any member bank as defined in * * * the Federal Reserve Act, to certify any check drawn upon such * * * member bank unless the person, firm, or corporation drawing the check has on deposit with such * * * member bank, at the time such check is certified, an amount of money not less than the amount specified in such check. Any check so certified by a duly authorized officer, director, agent, or employee shall be a good and valid obligation against such * * * member bank; but the act of any officer, director, agent, or employee of any such * * * member bank in violation of this section * * * shall subject such member bank if a national bank to the liabilities and proceedings on the part of the Comptroller of the Currency provided for in section 5234, Revised Statutes [12 U.S.C. sec. 192]. (*U.S.R.S. sec. 5208; 12 U.S.C. sec. 501.*)

Any officer, director, agent, or employee of any * * * member bank who shall willfully violate the provisions of this section, or who shall resort to any device, or receive any fictitious obligation, directly or collaterally, in order to evade the provisions thereof, or who shall certify a check before the amount thereof shall have been regularly deposited in the bank by the drawer thereof, shall be deemed guilty of a misdemeanor and shall, on conviction thereof in any district court of the United States, be fined not more than $5,000, or shall be imprisoned for not more than five years, or both, in the discretion of the court. (*U.S.R.S. sec. 5208; 12 U.S.C. sec. 591.*)

[Par. 29] False Representation as to Federal Deposit Insurance Coverage.

No insured bank shall advertise or otherwise represent falsely by any device whatsoever the extent to which or the manner in which its deposit liabilities are insured by the Federal Deposit Insurance Corporation. Every individual, partnership, association, or corporation violating this subsection shall be punished by a fine of not exceeding $1,000, or by imprisonment not exceeding one year, or both. (*Fed. Res. Act, sec. 12B(v); 12 U.S.C. sec. 264(v).*)

[Par. 30] Prohibition of Loans to Bank Examiners.

No member bank and no insured bank as defined in subsection (c) of section 12B of this Act, no officer, director, or employee thereof shall hereafter make any loan or grant any gratuity to any bank examiner or assistant examiner who examines or has authority to examine such bank. Any bank officer, director, or employee violating this provision shall be deemed guilty of a misdemeanor and shall be imprisoned not exceeding one year, or fined not more than $5,000, or both, and may be fined a further sum equal to the money so loaned or gratuity given.

The provisions of this subsection shall apply to all public examiners and assistant examiners who examine member banks of the Federal Reserve System or insured banks, whether appointed by the Comptroller of the Currency, by the Board of Governors of the Federal Reserve System, by a Federal Reserve agent, by a Federal Reserve bank, or by the Federal Deposit Insurance Corporation, or appointed or elected under the laws of any State; but shall not apply to private examiners or assistant examiners employed only by a clearing-house association or by the directors of a bank. (*Fed. Res. Act, sec. 22; 12 U.S.C. sec. 593.*)

[Par. 31] Bank Acting as Agent for Other Parties in Making Loans on Collateral.

No member bank shall act as the medium or agent of any nonbanking corporation, partnership, association, business trust, or individual in making loans on the security of stocks, bonds, and other investment securities to brokers or dealers in stocks, bonds, and other investment securities. Every violation of this provision by any member bank shall be punishable by a fine of not more than $100 per day during the continuance of such violation; and such fine may be collected, by suit or otherwise, by the Federal Reserve bank of the district in which such member bank is located. (*Fed. Res. Act, sec. 19; 12 U.S.C. sec. 374a.*)

CIVIL LIABILITY OF DIRECTORS

Directors of a national bank may become liable for losses sustained by the bank due to some breach of statutory requirements participated in or assented to by the directors or because the directors have not exercised that degree of care and prudence required of directors under the common law. In most cases the issues involve both liability for statutory violations and common law liability for negligence. However, for clarity, we shall discuss these two general classes of liability separately.

IV. LIABILITY FOR STATUTORY VIOLATIONS

The statutory liability of directors is predicated upon two statutory provisions, one dealing with violations of the National Bank Act and related laws, and the other dealing with violations of the Federal Reserve Act. They are as follows:

[Par. 32] Liability for Violation of the National Bank Act.

If the directors of any national banking association shall knowingly violate, or knowingly permit any of the officers, agents or servants of the association to violate any of the provisions of this title [Title LXII of U.S.R.S., consisting of the National Bank Act and related laws], all the rights, privileges, and franchises of the association shall be thereby forfeited. Such violation shall, however, be determined and adjudged by a proper circuit, district, or Territorial court of the United States, in a suit brought for that purpose by the Comptroller of the Currency, in his own name, before the association shall be declared dissolved. And in cases of such violation, every director who participated in or assented to the same shall be held liable in his personal and individual capacity for all damages which the association, its shareholders, or any other person, shall have sustained in consequence of such violation. (*U.S.R.S. sec. 5239; 12 U.S.C. sec. 93.*)

[Par. 33] Liability for Violation of the Federal Reserve Act.

Should any national banking association of the United States now organized * * * fail to comply with any of the provisions of this Act applicable thereto, all of the rights, privileges, and franchises of such association granted to it under the national-bank Act, or under the provisions of this Act, shall be thereby forfeited. Any noncompliance with or violation of this Act shall, however, be determined and adjudged by any court of the United States of competent jurisdiction in a suit brought for that purpose in the district or territory in which such bank is located, under the direction of the Board of Governors of the Federal Reserve System, by the Comptroller of the Currency in his own name before the association shall be declared dissolved. In cases of such noncompliance or violation, * * * every director who participated in or assented to the same shall be held liable in his personal or individual capacity for all damages which said bank, its shareholders, or any other person shall have sustained in consequence of such violation. (*Fed. Res. Act, sec. 2; 12 U.S.C. sec. 501a.*)

The following are a few of the cases in which courts have imposed personal liability upon directors for violations of national banking statutes:

(A) EXCESSIVE LOANS AND INVESTMENTS

With certain exceptions, U.S.R.S. section 5200 (see [Par. 13], above) forbids a national bank to make loans to a single borrower in excess of 10% of its capital stock and surplus. Where the directors assent to the making of loans in excess of the maximum permissible amount, they may be held liable for any losses sustained, regardless of their motives, or the financial standing of the borrowers at the time the loans were made, or the value of any security taken; and such liability will not be limited to the portion of the loans in excess of the prescribed limit but may include the whole amount plus interest and less any recovery on the loans. *Corsicana National Bank v. Johnson*, 251 U.S. 68; *Rankin v. Cooper*, 149 Fed. 1010; *Gamble v. Brown*, 29 F. (2d) 366; *Hughes v. Reed*, 46 F. (2d) 435. Liability cannot be avoided by resorting to a colorable loan to two or more persons closely affiliated in interest to avoid the appearance of an excessive loan. *Corsicana National Bank v. Johnson, supra.*

Similar liability may be incurred by directors for violation of other sections restricting loans and investments by national banks, such as U.S.R.S. section 5136, and Sections 24, 23 and 24A of the Federal Reserve Act ([Pars. 15, 17, 18, and 19] above).

(B) FALSE REPORTS

U.S.R.S. section 5211 (see [Par. 24], above) requires the publication and submission to the Comptroller of the Currency of certain reports of the condition of national banks and their affiliates, If the directors knowingly authorize or acquiesce in the making of false reports they may become civilly liable to any person who is injured by relying on such published reports. *Chesbrough v. Williams*, 244 U.S. 72; *Yates v. Jones National Bank*, 206 U.S. 158; *Jones National Bank v. Yates*, 240 U.S. 541.

(C) IMPROPER DIVIDENDS

U.S.R.S. sections 5199 and 5204 ([Par. 26], above), set forth the circumstances in which dividends may be declared upon national bank stock. If the directors pay dividends contrary to these provisions or others relating to that subject, they may incur personal liability for damages sustained by the bank as a result. See *United States v. Britton*, 108 U.S. 199, at 206; also *Dudley v. Hawkins* 239 Fed. 386. It is to be noted that although these sections impose liability upon directors only if they "knowingly" violate the statutory provisions in declaring or paying dividends, the courts construe the word "knowingly" very broadly. For instance, if bank directors deliberately refrain from investigating a matter which it is their duty to investigate, or, having knowledge of facts which put them on notice of irregular or criminal acts, they deliberately refrain from utilizing available accounting methods and from employing independent auditors to determine the full extent of the loss to the bank, any resulting violation of the statute may be regarded as "in effect intentional" or as having been committed "knowingly". *F.D.I.C., Receiver of the Commercial National Bank of Bradford, Bradford, Pa. v. Mason*, (C.C.A. 3d, November 13, 1940) 115 F. (2d) 548.

(D) OTHER STATUTORY VIOLATIONS

In addition to the above examples, directors may also be liable for losses sustained by the bank or its depositors as the result of violations of any other laws set forth in this pamphlet, such as [Par. 20] (limiting the extent to which interest may be paid on deposits), [Par. 21] (limiting the extent to which loans may be made to officers of the bank), and [Par. 31] (forbidding banks which are members of the Federal Reserve System to act as agents for other parties in making loans to brokers collateralized by investment securities), or violations of any other provisions of the National Bank Act or the Federal Reserve Act. Furthermore, directors are responsible for losses resulting from *ultra vires* transactions (that is, transactions which are beyond the powers conferred upon the bank) in which they participated. See *Cockrill v. Abeles*, 86 Fed. 505.

V. COMMON LAW LIABILITY FOR NEGLIGENCE

[Par. 34]. Directors of a national bank are under a duty to use ordinary care and prudence in the administration of the affairs of the bank and if through their failure to do so a loss to the bank results, they may be held liable for such loss in a civil action for damages. *Briggs v. Spaulding*, 141 U.S. 132; *Rankin v. Cooper*, 149 Fed. 1010; *Gamble v. Brown*, 29 F. (2d) 366. In such an action each director is liable in his personal and individual capacity and may be sued alone or jointly with other directors. This is true whether his liability is based upon failure to perform a statutory duty or a common law duty. *Corsicana National Bank v. Johnson*, 251 U.S. 68; *Gamble v. Brown, supra.*

[Par. 35]. Directors are expected to retain and exercise general supervision over the affairs of the bank and they cannot discharge their duty by reposing the entire administration to officers selected by them, without supervision or examination (*Gibbons v. Anderson*, 80 Fed. 345, at 349; *Robinson v. Hall*, 63 Fed. 222, at 223); and for failure to exercise reasonable supervision over the conduct of such officers and the affairs of the bank the directors will be held liable for losses resulting from such negligence. *Bowerman v. Hamner*, 250 U.S. 504, at 513. The directors should give personal attention to reports of examination and to letters from supervising officials (*White v. Thomas*, 37 F. (2d) 452, at 453), and the United States Supreme Court has held that "disregard of the direction of the officers appointed by the law to examine the affairs of the bank is a violation of the law. Their directions must be observed." *Thomas v. Taylor*, 224 U.S. 73, at 82. They should also give personal attention to the contents of the statements of condition furnished to supervising officials and published. *Jones National Bank v. Yates*, 240 U.S. 541, at 563. Directors are expected to attend the meetings of the Board and, even though residing at a distance, the directors who fail to attend such meetings may nevertheless be held liable for losses sustained due to negligence, for they cannot shield themselves from liability by pleading ignorance of transactions in which they did not participate, when their ignorance is a result of their negligent inattention. *Bowerman v. Hamner, supra; Briggs v. Spaulding, supra; Ringeon v. Albinson*, 35 F. (2d) 753, at 755.

[Par. 36]. There are many other illustrations where directors may be held liable for losses due to their negligence, for instance: The making of loans where the security taken is insufficient; certifying or permitting checks to be certified on insufficient or overdrawn accounts; failure to appoint a discount and loan committee or an examining committee of the directors when required by the by-laws or necessitated by the volume of the bank's business or failure to see that such committees function, if appointed; failure to audit or examine the affairs and condition of the bank periodically or to cause same to be audited or examined (*F.D.I.C., Receiver of the Commercial National Bank of Bradford, Bradford, Pa. v. Mason*, (C.C.A. 3d, November 13, 1940) 115 F. (2d) 548); failure to use reasonable efforts to collect slow or doubtful assets; permitting improvident expenditures in the conduct of the bank's business; authorizing improvident investments. The directors may also be liable for allowing improvident overdrafts (*McCormick v. King*, 241 Fed. 737, at 743), for damages resulting from failure to charge off assets at the direction of the Comptroller or for representing such assets to be good, after such notice (*Thomas v. Taylor, supra*), for losses resulting from failure to require proper bond covering officers and employees of the bank (*Robinson v. Hall, supra*). For a case discussing various phases of common law liability of directors of a national bank, see *Atherton v. Anderson*, 99 F. (2d) 883.

VI. EXAMINATIONS BY DIRECTORS

[Par. 37]. In General.

In connection with the annual or semiannual examinations made by examining committees or by accountants at the instance of the board of directors, the following suggestions are made as to the general points that should be covered:

(1) The cash should be counted and the total compared with the books of the bank. Cash items should be carefully scrutinized, and any improper items, such as unposted checks held for the purpose of not showing overdrafts, and other items that can not be readily converted into cash, should be reported.

(2) The bonds and other securities of the bank should be examined and those not on hand should be verified by reference to the receipts of the parties with whom they are deposited, and if the receipts are old they should be verified by correspondence. The market value and the amount at which carried on the books in the aggregate should be shown, and any stocks held by the bank should be listed, with a statement showing the reason the securities were taken by the bank.

(3) The notes should be carefully checked and their total compared with the general ledger. The genuineness, value, and security of each note, and of any collateral thereto, should be carefully determined, and any losses ascertained, or probable, in the judgment of the committee, should be noted. The liabilities of each of the larger borrowers, and loans to affiliated interests, should be aggregated and carefully considered. The report should also show the general character of the loans—whether well distributed; the general character of the collaterals; whether corporations in which officers or directors are interested borrow to an undue extent; also any large liabilities of the officers or directors. It should also be shown whether all paper claimed by the bank as its own property, including collaterals, is properly indorsed or assigned to it, and all mortgages recorded. Any loans exceeding 10 per cent of the capital and surplus of the bank should be reported. The signatures of all note makers and indorsers should be carefully scrutinized, and any erasures and alterations or any indications of manipulation should be carefully investigated and reported to the full board. All overdue paper should be listed and comment made as to its collectibility.

(4) The certificates of deposit and the cashier's checks should be verified by totaling those outstanding as shown by the register and comparing with the general ledger, and also by comparing the canceled certificates and checks with the register and checking them against the stubs.

(5) The copy retained by the bank of the report of condition made to the Comptroller at the last call should be compared with the bank's books at that date, particularly with reference to the excessive loans and directors' and officers' liabilities reported.

(6) The bank's last reconcilements of accounts with correspondent banks should be compared with the bank's books, and a transcript of the bank's account from the date of the last reconcilement to the date of the examination sent to the correspondent bank with a request for verification. Balances with nonmember banks in excess of 10 per cent of the capital and surplus should be reported.

(7) Individual ledger balances should be verified in such manner as the directors may deem advisable, by calling in pass books, by sending out reconcilements of certain accounts selected by the directors, or in some other suitable way. A trial balance of the ledger should be taken by some member of the committee, or at least by some person other than the clerk engaged on the ledger.

(8) Overdrafts should be totaled and carefully considered, and the report should show any estimated losses.

(9) The committee should consider carefully the "profit and loss" and the "expense" accounts, with a view of determining whether the charges against those accounts are proper, whether the earnings of the bank warrant the expense charges, and whether the bank is making a legitimate profit.

(10) The examining committee should inquire carefully into the arrangement of the working affairs of the bank and ascertain whether any employee who keeps the individual ledger receives deposits or balances pass books; and whether the employees are properly bonded, and in whose custody the bonds are lodged.

(11) Any liability of the bank for borrowed money should be listed, and the proper authority and the necessity for such borrowing ascertained. The total amount of the present liabilities of that nature should be reported to the board, including money borrowed from other banks on certificates of deposit.

The report of the directors or the examining committee should show that these points have been covered, and should recite any deficiencies discovered.

The report should also contain a complete statement of the total assets and liabilities of the bank, with any additions or deductions that in the judgment of the directors should be made as a result of their investigation. There should also be included a detailed statement of the loans which the directors estimate as worthless, doubtful, or insufficiently secured, giving reasons therefor, and as nearly as possible the real value.

A statement should also be made of any matters which in the opinion of the committee affect in any way the bank's solvency, stability, or prosperity.

It is believed that there are few instances where the examining committee can not, if they will take the necessary time, cover these points fully and satisfactorily.

An examination twice a year, along the lines indicated, by a committee of the directors who will give sufficient time to the work to make it thorough and complete, can not fail to be of great benefit to all concerned, and this the directors owe to the shareholders who have placed them in their positions of trust.

A complete report of each examination should be preserved in the files of the bank and be accessible to the bank examiner when examining the bank.

[Par. 38] Trust Department.

In those national banks which have been granted permits by the Federal Reserve Board to exercise trust powers under Section 11(k) of the Federal Reserve Act and which are administering trusts, the examining committee should conduct a thorough examination of the trust department. In making their examinations of the trust department the committee should proceed as follows:

(1) Seal the compartments in the vault containing trust securities, and take possession of the books and records of the department.

(2) Count any cash in the department and make a record of all trust securities in the department not in the vault. If any trust securities are out of the department temporarily, make a record of the receipts for verification.

(3) Take off a cash proof. This is a proof of the uninvested principal and income, cash due corporate trusts, cash held for account of sinking funds, and any other cash liability accounts to prove with the deposits of the trust department in the banking department, or in other banks.

(4) See that the bonds held by the trust department as security for trust funds on deposit in the banking department are of a market value in an amount sufficient to cover those deposits.

(5) Carefully inspect the trust ledger and security ledger and check up any important changes since the last examination, such as trusts closed out, new trusts received, purchases and sales of securities, large distributions of income, and commissions taken.

(6) Check all securities and other assets held by the trust department. Make a thorough examination and analysis of the investments which have been made for account of the various trusts to determine their desirability and present worth. A periodical appraisal of all trust securities is desirable and important.

(7) The committee should have before it the last report of the national bank examiner of the trust department, and any letters from the Comptroller of the Currency relating to that department, with the view of verifying and the correction of any exceptions which may have been called to the attention of the bank.

(8) The examining committee should make any observations necessary to come to a conclusion concerning the supervision and general management of the trust department, and incorporate their recommendations in their report to the Board of Directors.

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[PAR. 39]. VII: GENERAL FORM OF BYLAWS OF NATIONAL BANKS

BYLAWS OF

THE..................... NATIONAL............................. BANK OF

....

ORGANIZED UNDER THE NATIONAL BANKING LAWS OF THE UNITED STATES

ANNUAL MEETING

SECTION 1. The regular annual meetings of the shareholders of this bank for the election of directors shall be held at its banking house on the day in January of each year provided in the articles of association.

Unless otherwise provided by the articles of association, a notice of each annual shareholders' meeting, setting forth clearly the time, place, and purpose of the meeting, shall be given, by mail, to each shareholder of record of this bank, at least 10 days prior to the date on which such meeting is to be held; but any failure to mail such notice, or any irregularity therein, shall not affect the validity of such meeting or of any of the proceedings thereat. Such notice may be waived in writing.

The shareholders shall meet on the day appointed and shall elect a chairman and a secretary. The president of the bank shall then make a report to the shareholders showing the condition of the bank with a review of the business for the year.

SEC. 2. A record shall be made of the shareholders represented in person and by proxy, after which the shareholders shall proceed to the election of directors and to the transaction of any other business that may properly come before the meeting. A record of the shareholders' meeting, giving the names of the shareholders present and the number of shares of stock held by each, the names of the shareholders represented by proxy and the number of shares held by each, and the names of the proxies, shall be entered in the records of the meeting in the minute book of the bank. This record shall show the names of the shareholders and the number of shares voted for each resolution or voted for each candidate for director.

Proxies shall be secured for the annual meeting alone, shall be dated, and shall be filed with the records of the meeting. No officer, director, employee, or attorney for the bank may act as proxy.

The chairman or secretary of the meeting shall notify the directors-elect of their election and of the time at which they are required to meet at the banking house for the purpose of organizing the new board. At the appointed time, which as closely as possible shall follow their election, the directors-elect shall convene and organize and then appoint officers and fix salaries for the ensuing year. The resolutions appointing the officers and fixing their salaries shall be recorded in the bank's minute book.

The president or cashier shall then forward to the office of the Comptroller of the Currency a letter stating that a meeting of the shareholders was held in accordance with these bylaws, stating the number of shares represented in person and the number of shares represented by proxy, together with a list of the directors elected and the report of the appointment and signatures of officers.

SEC. 3. If, for any cause, the annual meeting of shareholders for the

election of directors is not held on the date fixed in the articles of association, such meeting may be held on some other day, notice thereof having been given in accordance with the requirements of section 5149, United States Revised Statutes, and the meeting conducted according to the provisions of sections 1 and 2 of these bylaws.

OFFICERS

SEC. 4. The officers of this bank shall be a president, vice president (who shall be members of the board of directors), cashier, and such other officers as may be from time to time appointed by the board of directors, by whom their several duties shall be prescribed.

SEC. 5. The president shall hold his office for the current year for which the board of which he shall be a member was elected, unless he shall resign, become disqualified, or be removed; and any vacancy occurring in the office of president or in the board of directors shall be filled promptly by the remaining members.

SEC. 6. The cashier and the subordinate officers and clerks shall be appointed to hold their offices, respectively, during the pleasure of the board of directors.

SEC. 7. The cashier of this bank shall be responsible for all moneys, funds, and valuables of the bank, and shall give bond, with security to be approved by the board, in the penal sum of ________ dollars, conditioned for the faithful and honest discharge of his duties as such cashier, and that he will faithfully apply and account for all such moneys, funds, and valuables, and deliver the same to the order of the board of directors of this bank, or to the person or persons authorized to receive them.

SEC. 8. The president of this bank shall be responsible for all such sums of money and property of every kind as may be intrusted to his care or placed in his hands by the board of directors or by the cashier, or otherwise come into his hands as president, and shall give bond, with security to be approved by the board in the penal sum of ________ dollars, conditioned for the faithful discharge of his duties as such president, and that he will faithfully and honestly apply and account for all sums of money and other property of this bank that may come into his hands as such president, and pay over and deliver the same to the order of the board of directors, or to any other person or persons authorized by the board to receive the same.

SEC. 9. The teller shall be responsible for all such sums of money, property, and funds of every description as may from time to time be placed in his hands by the cashier, or otherwise come into his possession as teller; and shall give bond, with security to be approved by the board, in the penal sum of ________ dollars, conditioned for the honest and faithful discharge of his duties as teller, and that he will faithfully apply, account for, and pay over all moneys, property, and funds of every description that may come into his hands, by virtue of his office as teller, to the order of the board of directors aforesaid, or to such person or persons as may be authorized to demand and receive the same.

SEC. 10. In the discretion of the board of directors, there may be substituted for the bonds provided in sections 7, 8, and 9 a blanket bond in the sum of ________ dollars covering all officers and employees of the bank.

SEAL

SEC. 11. The following is an impression of the seal adopted by the board of directors of this bank:

{ Impression of seal }

CONVEYANCES OF REAL ESTATE

SEC. 12. All transfers and conveyances of real estate shall be made by the association, under seal, in accordance with the orders of the board of directors, and shall be signed by the president or cashier.

INCREASE OF STOCK*

SEC. 13. In case of any increase in the capital stock of the association (of any class) other than by way of a stock dividend, the new shares shall be offered for subscription to the holders of record of all shares of stock (of that class) at the time outstanding, in proportion to the number of shares of such stock (of that class) held by them respectively, by mailing, first-class postage prepaid, to such holders, at their respective addresses as shown on the books of the association, transferable subscription warrants exercisable at any time on or before 30 days from the date of such mailing. (If at the expiration of such subscription rights any of the new shares have not been subscribed for, such shares shall be offered for subscription to the holders of record of all other shares of stock of all other classes at the time outstanding, in proportion to the number of such shares held by them respectively, and notice shall be given as above provided). If at the expiration of (both of) such subscription rights any of the new shares have not been subscribed for, such unsubscribed new shares may be issued and sold at such price, not less than the par value thereof, to such persons and on such terms as the board of directors may determine.

BANKING HOURS

SEC. 14. This bank shall be open for business from ____ o'clock a. m. to ____ o'clock p. m. of each day of the year, excepting Sundays and days recognized by the laws of this State as holidays.

DIRECTORS' MEETINGS

SEC. 15. The regular meetings of the board of directors shall be held on the __________ of each month. When any regular meeting of the board of directors falls upon a holiday, the meeting shall be held on such other day as the board may previously designate. Special meetings may be called by the president, cashier, or at the request of three or more directors.

DISCOUNT COMMITTEE

SEC. 16. There shall be a committee, to be known as the discount committee, consisting of the president, cashier, and __________ directors appointed by the board every __________ months, to continue to act until succeeded, who shall have power to discount and purchase bills, notes, and other evidences of debt, and to buy and sell bills of exchange; and who shall, at each regular meeting of the board of directors, submit in writing a report of all bills, notes, and other evidences of debt discounted and purchased by them for the bank since their last report. The board of directors shall approve or disapprove the report of the discount committee, such action to be recorded in the minutes of the meeting.

MINUTE BOOK

SEC. 17. The organization papers of this bank, the returns of the judges of the elections, the proceedings of all regular and special meetings

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* If the bank has more than one class of stock outstanding, eliminate the parentheses. If the bank has but one class of stock outstanding, eliminate the parentheses and the words within such parentheses.

of the directors and of the shareholders, the bylaws and any amendments thereto, and reports of the committees of directors shall be recorded in the minute book; and the minutes of each meeting shall be signed by the president and attested by the cashier.

TRANSFERS OF STOCK

SEC. 18. The stock of this bank shall be assignable and transferable only on the books of this bank, subject to the restrictions and provisions of the national banking laws; and a transfer book shall be provided in which all assignments and transfers of stock shall be made.

SEC. 19. Certificates of stock, signed by the president or a vice president, and the cashier or an assistant cashier, may be issued to shareholders, and when stock is transferred the certificates thereof shall be returned to the association, canceled, preserved, and new certificates issued. Certificates of stock shall state upon the face thereof that the stock is transferable only upon the books of the association, and shall meet the requirements of section 5139, United States Revised Statutes, as amended.

EXPENSES

SEC. 20. All the current expenses of the bank shall be paid by the cashier, who shall every 6 months, or oftener if required, make to the board a detailed statement thereof.

CONTRACTS

SEC. 21. All contracts, checks, drafts, etc., shall be signed by the president or cashier.

EXAMINATIONS

SEC. 22. There shall be appointed by the board of directors a committee of ________ members, exclusive of the active officers of the bank, whose duty it shall be to examine, every 6 months, the affairs of this bank, count its cash, and compare its assets and liabilities with the accounts of the general ledger, ascertain whether the accounts are correctly kept and the condition of the bank corresponds therewith, and whether the bank is in a sound and solvent condition, and to recommend to the board such changes in the manner of doing business, etc., as shall seem to be desirable, the result of which examination shall be reported in writing to the board at the next regular meeting thereafter.

SEC. 23. The board of directors shall have power to change the form of the books and accounts when deemed expedient, and define the manner in which the affairs of the bank shall be conducted.

QUORUM

SEC. 24. A majority of all the directors is required to constitute a quorum to do business. Should there be no quorum at any regular or special meeting, the members present may adjourn from day to day until a quorum is in attendance. In the absence of a quorum no business shall be transacted.

CHANGES IN BYLAWS

SEC. 25. These bylaws may be changed or amended by the vote of a majority of the directors at any regular or special meeting of the board, provided, however, that the directors shall have been given 10 days' notice of the intention to change or offer an amendment thereto.

Bruce C. Peck
380 Riverside
05-7517

END OF

TITLE